DOW THEORY LETTERS INC.

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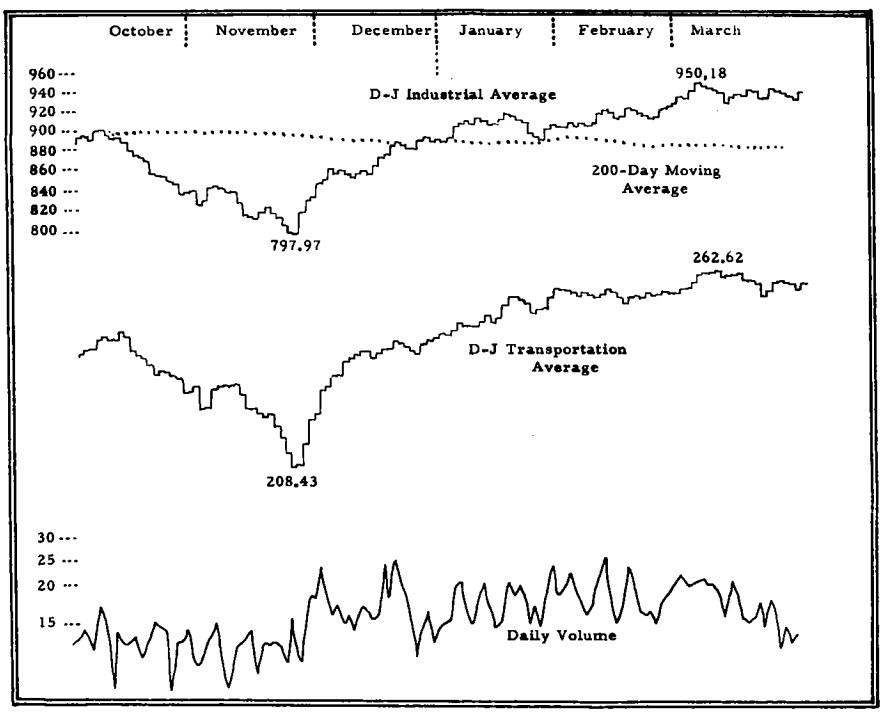
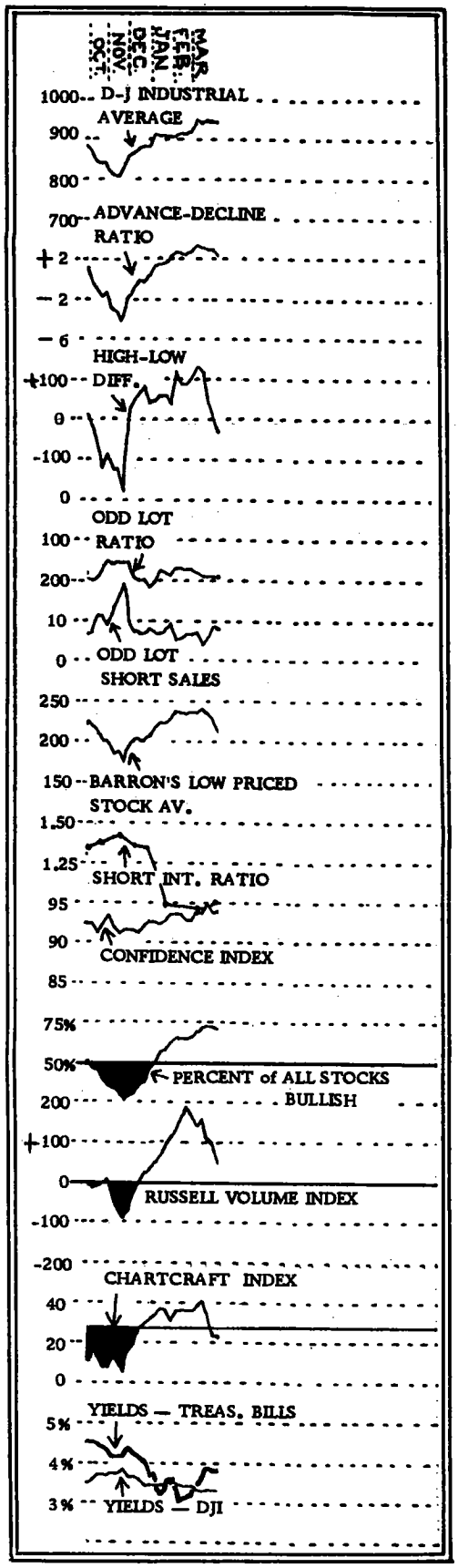
QUOTE OF THE WEEK: (From Paris): Treasury Undersecretary Volcker said, "We've run out of gas. Who will be the United States of the 1970's -- who will be willing to run the deficits in the 1970's that we did in the '50's and '60's?" And the answer of course, is that as long as he can get away with it, Mr. Nixon will.

THE PICTURE: In the face of the Meany-Woodcock exit from President Nixon's Pay Board, the February cost-of-living increase was announced as .5% or 6% annually (with food prices taking their sharpest jump in 14 years). Thus, one wonders whether Labor wants to disassociate itself from the galloping inflation which is obviously continuing, or whether Mr. Meany and friends merely want to be free to oppose Mr. Nixon (which would be somewhat difficult if they were still on the Pay Board which was set up by the Administration).

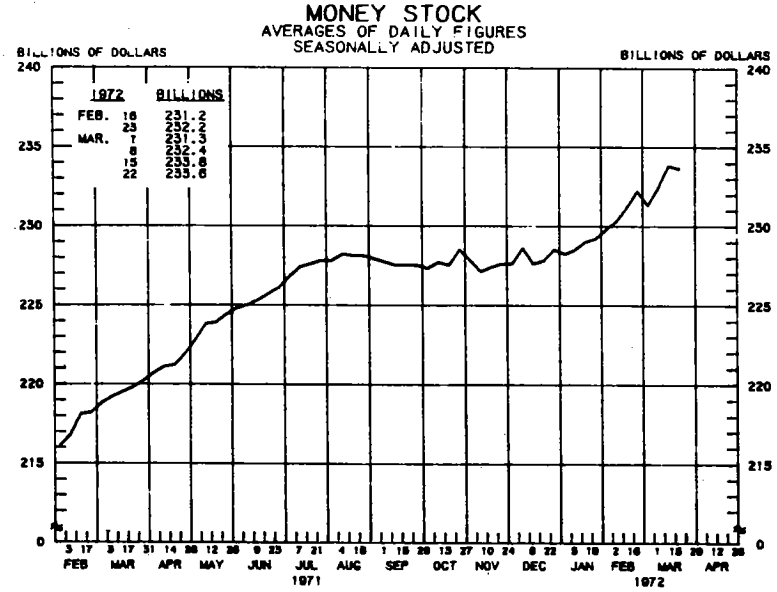
At any rate, our Washington leaders insist on pretending that "all is well," and we are again requested to "wait for next month's figures." What they don't say is that the nation's money supply (the gas that fuels the inflation) is continuing to expand at a shameful rate, and the chart on page 2 shows the new high in the money supply as fiat dollars were pumped out for an 11.7% increase between January 12, 1972, and March 15, 1972.

The Administration has put itself in the lamentable position of ballooning the money supply, facing politically disastrous inflation, and still not being able to send the D-J Industrial Average up to headline-grabbing all time highs (to "1000 or 1100" as promised by Treasury Secretary Connally). Now there is nothing more irritating than blowing your whole bankroll on the slot machines without even getting near the jackpot. But that is very close to what the Nixon Administration is doing in its calculated gamble aimed at getting the economy and the Dow up into the wild blue yonder.





I have been stressing the fact that the market boiler has absorbed record volume during 1972 so far (see later study in this Letter), and that annoying D-J Industrial Average simply will not go through its 1966 high of 995.15. What a tempting target the 995.15 level must be for this Administration. I would guess that Mr. Nixon and Mr. Connally go to sleep dreaming of the voters (the woolly sheep) jumping over a fence marked "the 995.15 level." But what of the nightmares? Those must be a sudden decline, and a plunge as the little sheep are caught in the waiting arms of the bear and hurled down, down into the icy abyss of the 800, the 700, then the 600 and below level (readers, pardon my fantasies if you will, but it is a very difficult task trying to tune into the unconsciouses of our Washington leaders)!

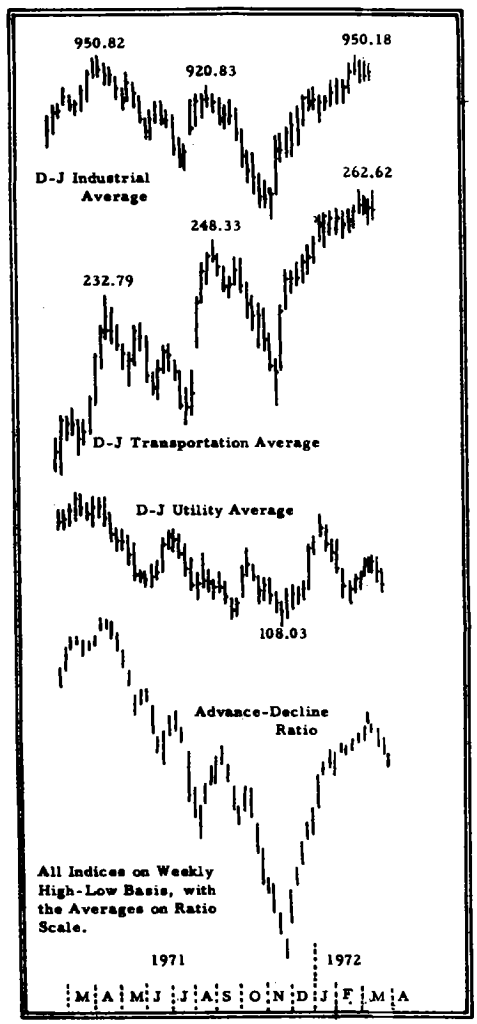


At any rate, all that inflating and jawboning now seems to be having some kind of effect on the economy. It is sporadic, to be sure, and it is spotty, but industrial production has been moving up, sales have been expanding, and enough has been happening so that Washingtonians must feel reasonably confident that they have the nation's business well in hand (at least until election time).

Yet there is a fly in the ointment. And that is that the market has a strange habit of discounting the best that can be seen ahead — and then preparing itself for the downward cycle. The fact is that for months Mr. Nixon and company have been saying that 1972 would be a "very good year," and Treasury Secretary Connally has promised that we would see the Dow over "1100." An awful lot of people believed those two gentlemen, and they have undoubtedly bought equities in anticipation of those happy events. Yet, with it all, the Dow is still well below the 1000 mark. I have been saying all along that I expected 1972 to act, in general, like a primary bear market year. It is fairly typical during primary bear markets for the highs for the year to be established in the first quarter, and the lows for the year to appear in the final quarter.

If so, this sets up the interesting possibility that the March 6 Dow peak of 950.18 will represent the high for 1972, and that the Dow will work progressively lower during the remainder of the year, hitting its final low during the October-December quarter or (interestingly enough) around election time. Is this possible? Is it possible that the Administration, which has been playing Russian Roulette with the U.S. economy, will be served with a gift of final quarter lows in the stock market? Could all that "inflation, fiat paper and tears" end up with such a thankless performance by Wall Street? It could happen, for as I have written many times before, the stock market cannot be controlled (in a primary sense) by any man, group of men, or by any Presidential or Congressional edicts. The market is a law unto itself, and man cannot reverse the primary trend (he can only repress it temporarily).

I have noted in recent Letters that the four major indicators which we follow allow for the possibility of important trouble ahead. Referring to the weekly chart on page 2, we see that the Transportation Average since 1971 has traced out a series of three successive ascending peaks, 232.79 in April, 1971, 248.33 in September, 1971, and 262.62 in March, 1972. The Industrial Average has failed to confirm, and as of this writing the Industrials have never bettered their April, 1971, peak of 950.82. On March 6, 1972, in fact, Industrials recorded a high of 950.18, just 64¢ under the April, 1971, peak.

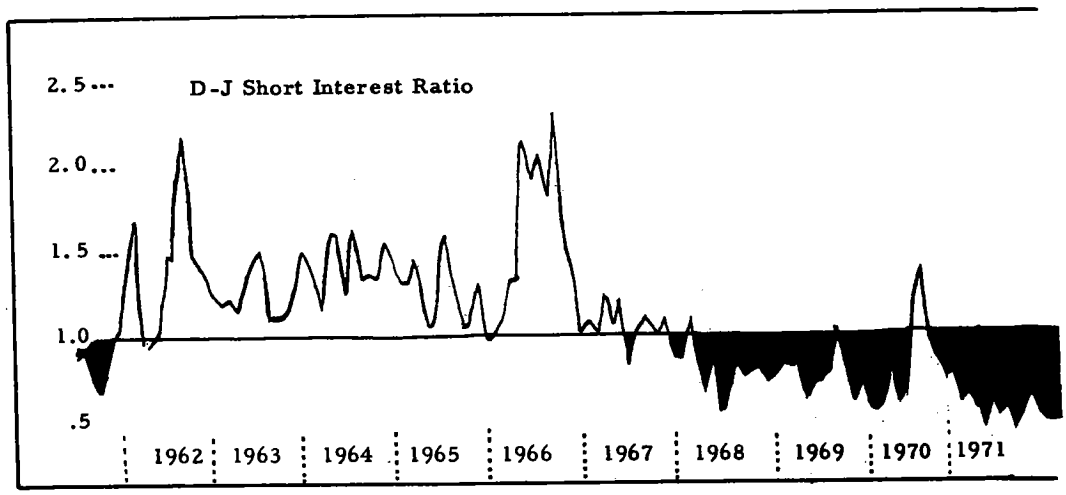


This may seem like a minor matter, but the fact is that the situation now is not too different from that which existed in late-1968. At that time the Transports had rallied to all-time highs, and most of the major Averages (S & P, N.Y.S.E., etc.) had also advanced to record highs. Only the Dow refused to better its 1966 peak, and during that period I was one of the few who termed the situation highly dangerous. And dangerous it was, as the years 1969 and 1970 proved.

Today, we have the spectacle of the Transports and many other widely followed Averages at new highs, yet the Dow Industrials have not even hurdled their April, 1971, highs, much less their 1968 or 1966 highs. Volume has been explosive and bullishness has been rampant. But as we have seen so many times before in history, the story is in the Averages, not in the mass bullishness or in the pronouncements from high places.

Meanwhile, the third D-J Average, the Utility Average (which represents the highest quality of the three) is leading the way down. This Average (which led the path up during the entire 1949-1966 primary bull market) is in a seven-year downtrend. Furthermore, it is currently within a point of breaking to a new low for the year (the 1972 low was 111.42).

Finally, the advance-decline ratio is far below its April, 1971, peak, and therefore joins with Industrials and Utilities in refusing to confirm the superior performance of the very speculative Transportation Average. While few investors or advisory services seem to be following the picture which I have presented here, I am sure that if our leaders in Washington were familiar with Dow Theory, they would agree that I have given them food for thought.



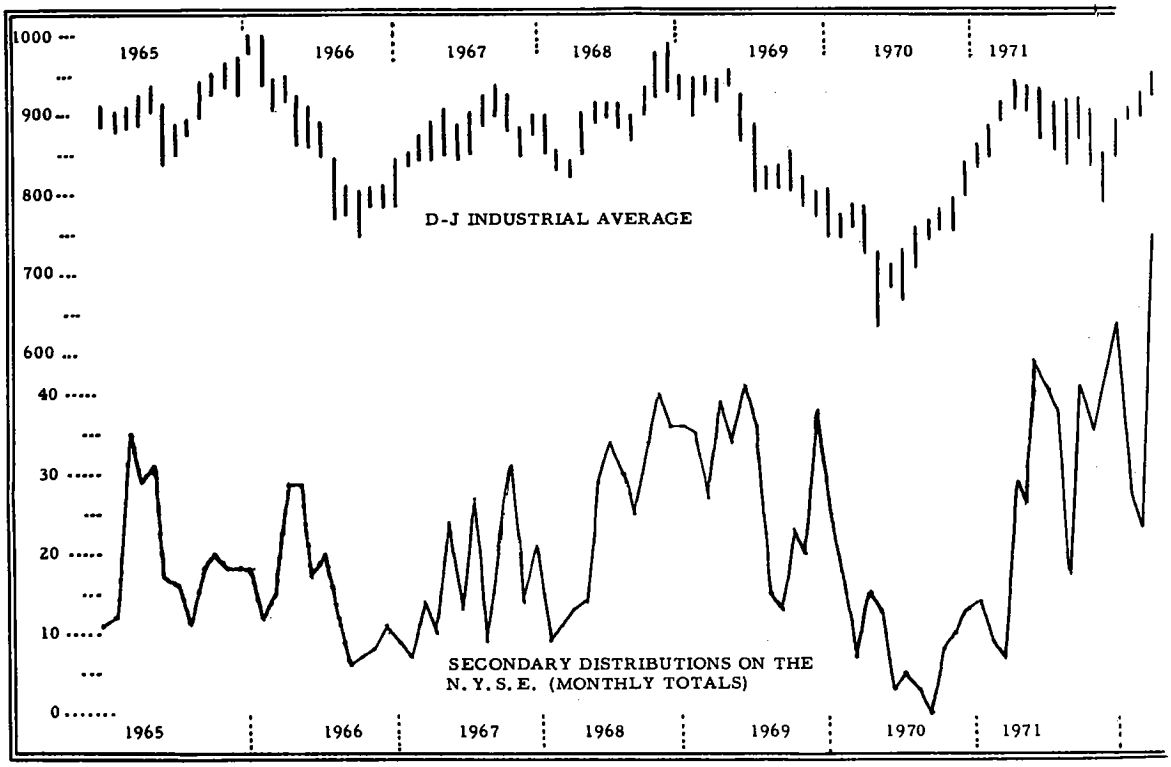
A few other technical considerations should be mentioned. The week ending March 24 brought the first 1972 "new low entries" in Barron's group listings. The two new group lows were Oils and Closed-End Investment Trusts.

The short interest ratio in the D-J Industrials (an indicator developed by Bill Gordon of New York and followed here regularly) dropped to .43 in March from .45 in February and .44 in January. The 3-month moving average of the Dow short interest ratio thereby sank to .44, its lowest level in its entire history (which began in 1931). The accompanying chart shows the DSIR going back to 1962 (for a further discussion of the DSIR see Letter 523).

I last discussed the secondary distribution index in Letter 517. Any time an index establishes a new record I like to review it, and that is what happened to the secondary distribution picture during March. As seen on the page 4 chart, March, 1972, brought out a whopping 59 secondaries, and since this process is admittedly a method of distributing large blocks of stock, March's record number of secondaries, I feel, is a most significant event. Note on the chart that a great many secondaries came out during late-1968 and early-1969, just as the market was preparing to nosedive with the Dow heading for 631. We are now building an even bigger "tower of secondaries" in this area (or since early 1971). I believe this massive amount of distribution is preparing the market for a vast amount of trouble to start between now and election time.

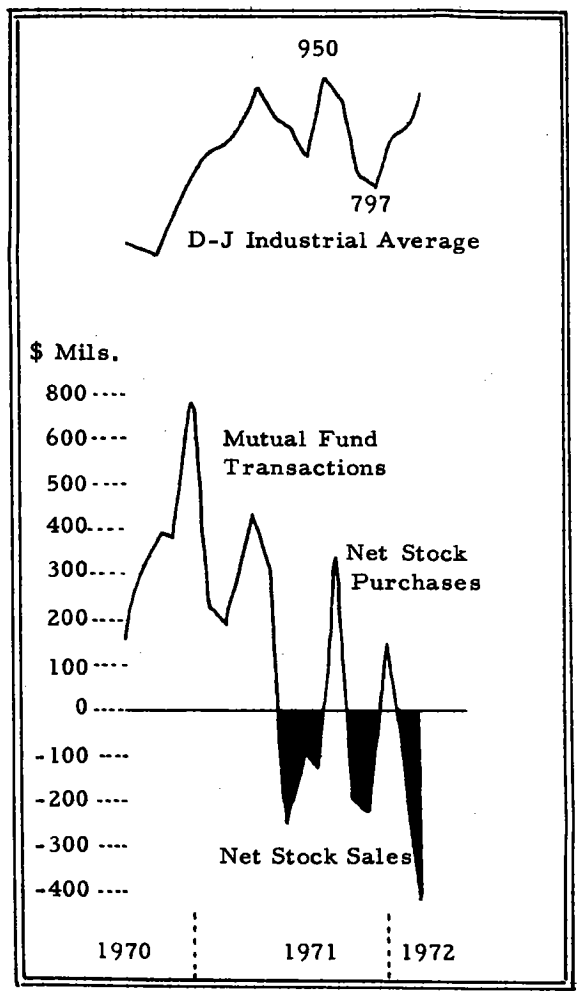
FUNDS: Back in Letter 506 I presented a study and chart showing what the mutual funds were doing in the way of providing "buying" power for the market. It was pointed out then that during mid-1971 the funds were net sellers of equities. But what was most startling about this was that for the first time in industry history fund redemptions were outdistancing purchases. This meant that the pressure was on the funds to pay out (and sell stock rather than to take in and buy stock).

With this Letter I am updating that report. It is interesting to note that during 1971 there were five months in which funds sold equities rather than purchased them. True, some of those equities may have been sold as switches for bonds, but the fact remains that equities were sold on balance by the funds.



The really important news was that during February, 1972, mutual fund redemptions outpaced purchases by a record $110 million. On top of this, perhaps sensing the disconcerting trend, the funds sold a total of $429 million in equities during February, the largest amount of net equity selling since 1970 (when the market was collapsing). The chart shows the trend of fund purchases and sales of equities since mid-1970, and it seems to me that we now have a trend. That trend is obviously towards the sale of equities in the face of the February continuation of fund redemptions over purchases (following four months of net purchases over sales).

I believe that the trend of both fund purchases and redemptions and the trend of fund purchases or sale of stocks is going to be down for the next few years or until this primary bear market terminates. So far, the trends in both categories have been spotty. But the February figures are eye-openers. The real problems could come during a severe downward phase of the bear market if fund dumping of equities starts running even higher than the $429 million of February, 1972. It would not shock me to see fund selling rise, for instance, to an average of half a billion dollars a month. Then we will note that the bear market is on in earnest and that the public is finally approaching total disillusionment.



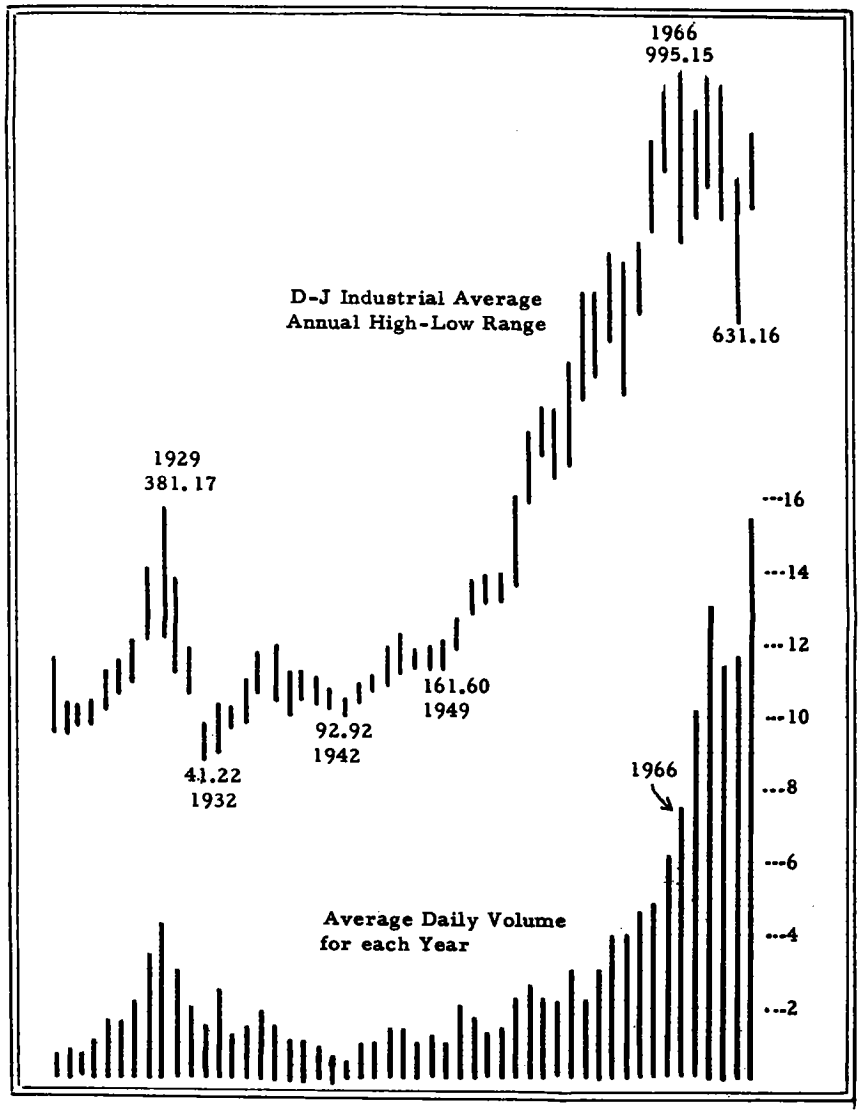
WHAT'S HAPPENING? The page 5 chart shows the annual high-low range for the Dow from 1921 to 1971 together with average daily volume for each of those years. The chart is of great interest to me.

Note that volume increased with prices all through the great 1921-29 bull market, peaking in 1929 with average daily volume of 4.27 million shares. Another bull market (1932-37) followed, and then came the bear market of 1937 to 1942. That bear market saw volume shrink (characteristic of bear market action) to an extreme low of 455 thousand shares (on average) per day during 1942. During 1942 the Dow hit the famous low of 92.92.

A bull market carried from 1942 to 1946, then a bear market into 1949, and again average volume shrunk drastically (1949 average daily volume was 1.0 million shares. In 1949 we saw the beginning of the massive 1949 to 1966 bull market, and here the chart becomes interesting indeed. By 1966 the Dow had struck its bull market high of 995.15 and average daily volume in 1966 was 7.53 million shares.

But the incredible thing was that despite the fact that the Dow never bettered its 1966 bull market high, average daily volume kept increasing. In 1967 it was 10.0 million shares, in 1968 it was 12.9 million, in 1969 it was 11.4, in 1970 it was 11.5, in 1971 it jumped to 15.13 million shares. And in 1972, with the Dow still under the 995.15 peak of 1966, average volume is hitting new records.

My own interpretation is that a huge amount of distribution has gone on ever since 1966. Thus volume has been expanding steadily without commensurate increases in stock prices (see study of the Dow stocks in the last Letter). Nothing like this has ever happened in the history of the price-volume relationship. My guess is that when prices finally turn down and the full brunt of the bear market hits, the ensuing collapse will be that much worse. Worse because of the unbelievable volume and distribution which has taken place since 1966.



MONEY & GOLD: I suppose the biggest recent news is the $597 million trade deficit of February, a deficit surpassed only once in history (last October, when it was $821 million). February's figures represented the fifth monthly deficit in a row, and they detracted considerably from the soothing words with which Washington has been attempting to lull our creditors.

Little is known regarding what the Europeans are doing on the gold front or for that matter what the Europeans are telling the Americans. However, Alden Wells, in his latest "Monetary Report," believes that the U.S. is moving inexorably towards convertibility, spurred on by alleged European ultimatums and more specifically Mr. Pompidou of France. Wells further states, "now that the United States Government has been forced to face facts, we believe there will be a gold price of not less than $100 per ounce, guaranteed by both America and European nations, before the end of the year." Mr. Wells has been remarkably right on a great many of his forecasts, and I, for one, would not want to bet against this one.

If Wells is correct, then what is gold doing at $48 per ounce on the free market? All I can say to that is that the scepticism regarding gold continues to be monumental, and that no major event is discounted by the market in a day. Furthermore, this is the age of the Washington jawboner, and jawboning has moved the market up and held the gold stocks down. Ultimately facts and reality always win over jawboning, but even the horrendous U.S. inflation and deficits have not convinced Americans that the writing is on the wall for gold and the dollar.

The Administration still tells us to "Wait for next month's figures" and strangely the majority continues to wait. Meanwhile, Europe has lost its patience, and is setting the apparatus into motion which will result in a much higher price for gold. Remember, Europe now has $24 billion of gold with the U.S. actually owning considerably less than $10 billion. The figures speak for themselves. Europe is going to protect its assets, and the U.S. has few gold assets to protect. Under these conditions, the men with the money will win.

In the latest issue of the authoritative Bank Credit Analyst (April) Editor Donald Storey writes: "The outlook for gold has clarified considerably following the developments after August 15, 1971. The gradual demonetization of the dollar and its implications for inflation and instability have the effect of returning to gold its monopoly power of being the only true international money. Gold bullion and gold shares should continue to provide investors with an important hedge against inflation and protection from the risks arising from the increasing instability in all financial areas..."

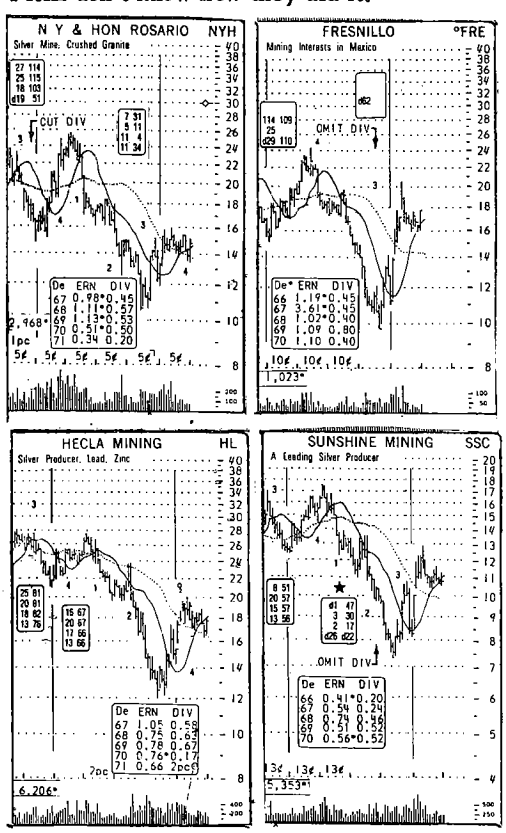
* * * *

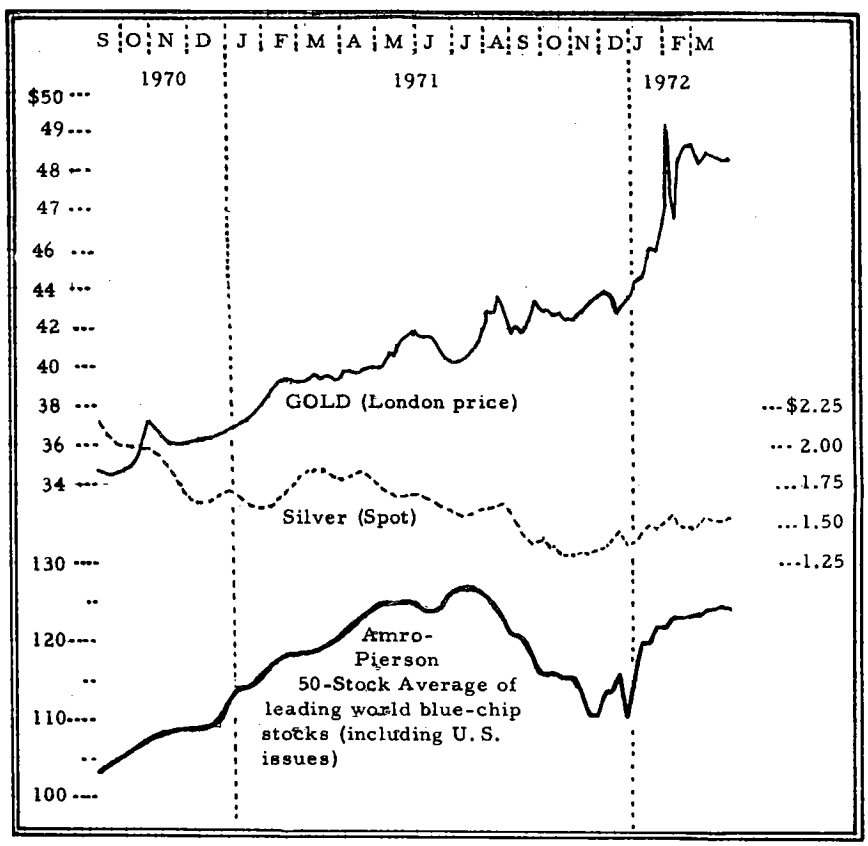
Our regular gold-silver chart switches in interest to the silver section this week, with spot silver rising to a 7-month high of $1.56. The build-up in the price of silver has been long and laborious, and to my mind the first real target for silver would be around $1.80, at which price it would better the 1971-72 high. Such a move could come before this year is out.

I am including charts of four silver mining companies, and all of these stocks are far down from their all-time highs. That, plus what I feel is the brightening outlook for the price of silver, makes these stocks interesting long-term investments and valid hedges against inflation. The gathering interest in silver (on the part of the public) may be seen in the silver consumption figures of the Franklin Mint (now the second largest user of silver after International Silver). In 1970 Franklin consumed over 6 million ounces of silver, in 1971 the consumption rose to 7-8 million oz., and in 1972 consumption is estimated at 8-10 million oz. (These statistics courtesy of Green's Commodity Market Comments).

On the gold side, the higher price of gold is beginning to be reflected in earnings. For instance, earnings of the Gold Fields Group for the quarter ending December 31, 1971, rose by 25%. Gold Fields' final quarter sales of gold rose to $10.5 million, 32% over the third quarter (Gold Fields operates 7 gold mines). As seen on the gold-silver chart, the London dollar price of gold during first quarter, 1972, was much higher than that of the third and fourth quarter, 1971, and earning on gold shares should continue to rise.

REPORT ON MY "VACATION": As stated in the last mailing, I took a vacation. With two VW campers and one VW bug and my three daughters and the eight girls and boys who live with us, we headed for the Grand Canyon. We broke a generator outside of Needles, California, and had it fixed by one of the most honest shops I have ever run into. Needles, by the way, is on the desert and is one of the hottest spots in the U.S. We got to the Grand Canyon, froze in our sleeping bags (temperature 100 at Canyon bottom), and I rose at 5 A.M. to see the magnificent Canyon sunrise. We drove all night heading back to San Diego, and I was frankly scared to death when we hit a terrific sand storm near Palm Springs and Desert Hot Springs. Off the desert into Riverside (fantastic farms there), we drove South into lush Escondido, and then back to San Diego. And that's the fabulous Southwest for you, oceans, mountains, snow, burning deserts, sand storms, great people, the Grand Canyon and the thrill of space, endless space. I kept wondering how the pioneers ever made it across the Southwest to the California Coast. I still don't know how they did it.





Silver charts courtesy Quote Digest, Box 213, Wichita, Kans. 67201